Special Commentary — May 10, 2024

Why Your Overseas Vacation Is Bad News for the Economy

Summary

This report revisits some classic implications of a strong dollar on various sectors of the U.S. economy with an eye toward shining a light on an under-appreciated trade factor: foreign travel.

Economist(s)

Tim Quinlan
Senior Economist | Wells Fargo Economics
Tim.Quinlan@wellsfargo.com | 704-410-3283

Nicole Cervi
Economist | Wells Fargo Economics
Nicole.Cervi@wellsfargo.com | 704-410-3059

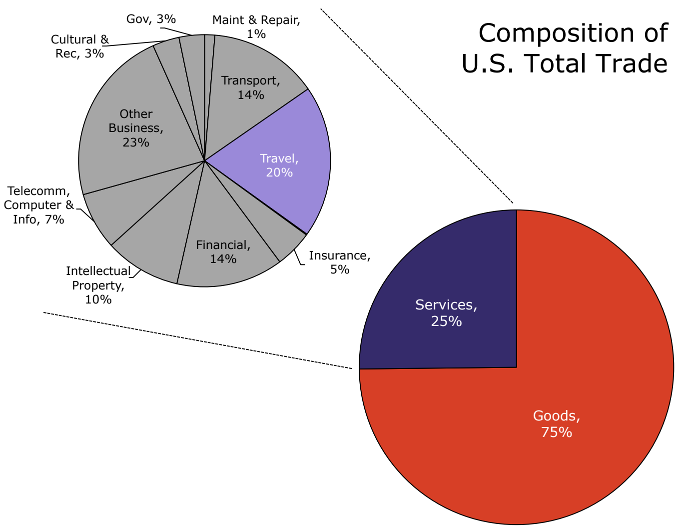
Have Dollar, Will Travel

When we think about international trade, tangible products like steel, chocolate and coffee often come to mind first. The intuition makes sense, especially given that merchandise goods comprise roughly three-quarters of total U.S. trade, with services representing the remainder (Figure 1). The service sector's relatively small share of trade has meant that this category of the U.S. trade balance is often overlooked. Yet no matter the type of product, changes in the dollar's exchange rate are consequential for the path of net exports and headline economic growth. In this report, we revisit some of the classic implications of a strong dollar and shine a light on an under-appreciated trade factor: travel services.

Trade and Dollar 101

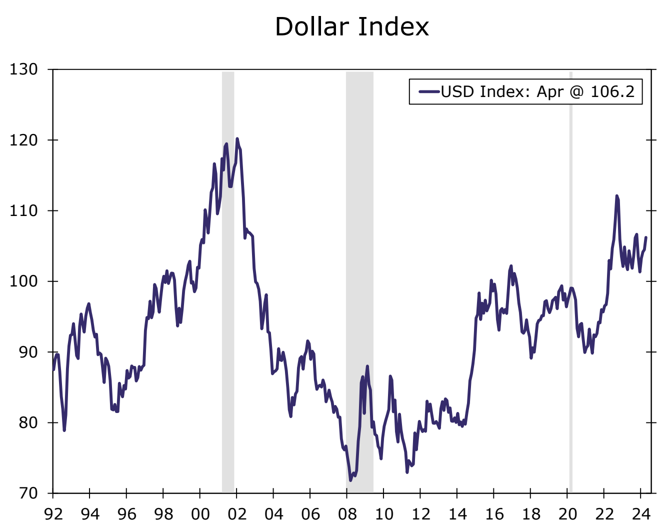
When the Federal Reserve embarked on its aggressive monetary policy hiking cycle in early 2022, the U.S. dollar strengthened against many foreign currencies (Figure 2). Dollar strength has persisted over the past year even with the Fed on hold, as robust domestic growth has been supportive of the greenback amid trailing growth in other advanced economies. What does a stronger dollar mean for trade?

Figure 1



Source: U.S. Department of Commerce and Wells Fargo Economics

Figure 2



Source: Bloomberg Finance L.P. and Wells Fargo Economics

All else equal, a strong dollar makes U.S. exports more expensive for foreign buyers and makes imports cheaper for domestic buyers. This dynamic can adversely affect American exporters as their goods and services become more expensive for foreign buyers, leading to a potential squeeze on exports. Conversely, imports become relatively cheaper, which can benefit domestic consumers by lowering the cost of goods and services.

The manufacturing sector often feels the brunt of a strong dollar because it is heavily reliant on export revenues. As exports become pricier for foreign buyers, demand for American-made products can soften. This can result in reduced production and potential job losses in this sector.

A somewhat less widely followed development is how Americans can stretch a buck as those dollars go further abroad, affording them a greater degree of purchasing power overseas. Because local prices in foreign countries are not significantly influenced by changes in the U.S. economy, a strong dollar can buy more goods when converted to the local currency. Expatriates, or U.S. citizens living and working overseas, will also see their cost-of-living decrease to the extent that they still use dollars or are paid in dollars.

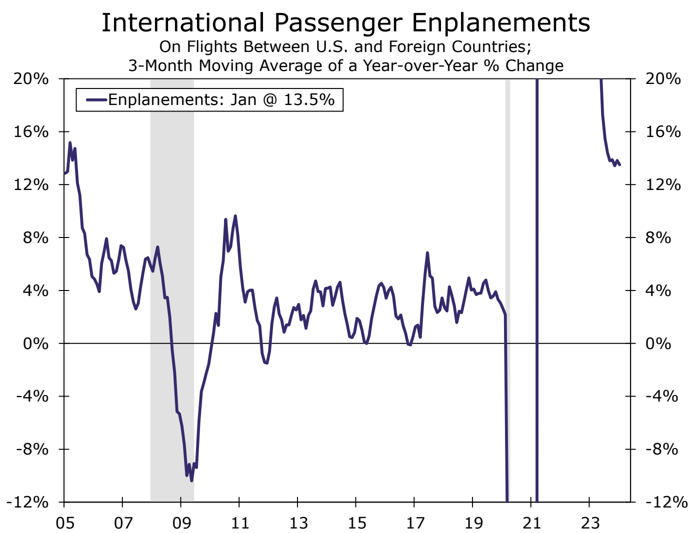
In short, a strong dollar allows Americans to get more “bang for their buck” when traveling abroad. Conversely, a weak dollar makes it more expensive to travel in other countries. In the past 20 years, the years 2008 and 2011-2014 stand out as points where the dollar was comparatively weak relative to other currencies.

What's Travel Got to Do with It?

Those periods are correlated with diminished foreign travel (Figure 3). The monthly U.S. trade report tallies imports of travel services (money spent by Americans traveling abroad) and exports of travel services (money spent by foreigners visiting the United States). Travel services are a "transactor" component of the report, meaning the dollar value of a traveler's expenditures, no matter the type of goods and services they are buying, is aggregated as a "travel service".

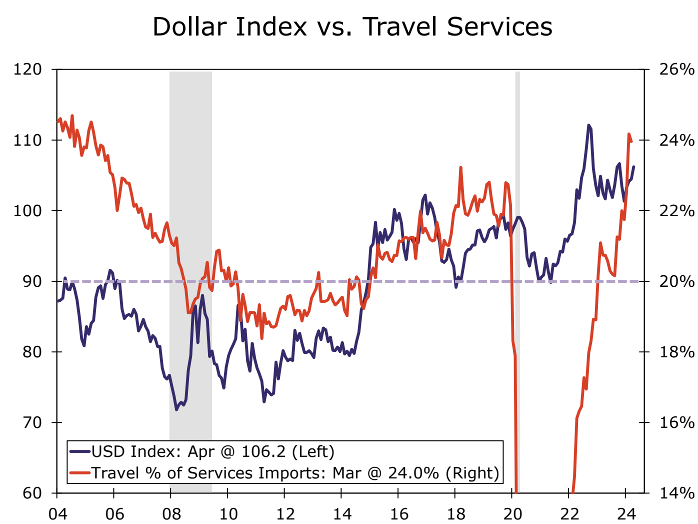
When evaluating travel services trade during the 20-year period that preceded the pandemic, imports of travel services bottomed out during the weak dollar periods. Appetite for travel is diminished when the dollar is weak. This is true in both absolute level terms, as well as when measured as a share of total service imports. In fact, with rare exception during that 20-year period, the only times when travel services as a share of total services imports were below 20% was during these weak dollar periods (Figure 4).

Figure 3



Source: U.S. Department of Transportation and Wells Fargo Economics

Figure 4



Source: Bloomberg Finance L.P., U.S. Department of Commerce and Wells Fargo Economics

All bets are off when it comes to the pandemic. Travel restrictions and closed borders canceled plans. But the world is getting back to normal. Travel imports averaged a 22% share of overall service imports in the two decades preceding the pandemic. We finally returned to that share for the first time since COVID struck in November 2023.

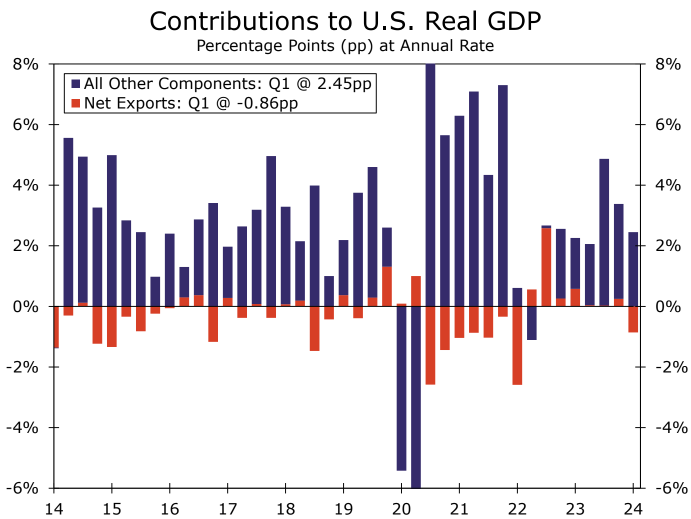
Americans are returning to foreign travel with a renewed vigor, which is evident in the strong rise in travel services imports recently. The share of service imports allocated to travel climbed to its highest since 2005 in the past few months. The greenback was strong in 2005, hitting a degree of strength that year that it would not exceed until 10 years later. The more recent normalization in foreign travel has occurred against a backdrop of positive real disposable income growth over the past year or so and amid a strengthening dollar. Exports of travel services (foreigners spending money in the United States) show a similar sensitivity to dollar valuation.

Implications for Headline Growth

Broadly speaking, bigger trade deficits subtract from real GDP growth, and smaller deficits add to it. The goods deficit might swell in a strong dollar environment as demand shifts toward relatively cheaper imported products—a dynamic that is generally well understood. The under-appreciated factor we are exploring here is how a strong dollar can also encourage Americans to engage in more foreign travel.

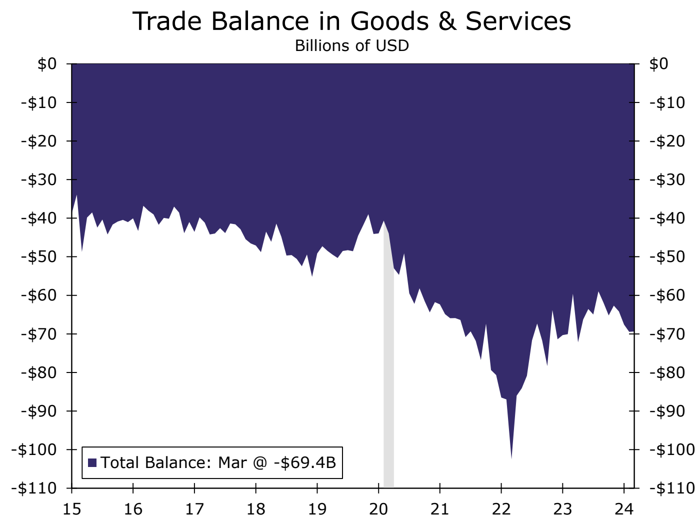
When Americans spend money abroad, that expenditure is counted as an import in the GDP accounts because it is consumption that does not contribute to the value-added of the U.S. economy. Thus, a surge in foreign travel by U.S. citizens can weigh on the services trade balance. On the services side of trade, the United States runs a trade surplus, so if foreign travel continues to ramp up alongside a swelling goods deficit, net exports could meaningfully weigh on real GDP growth (Figure 5).

Figure 5



Source: U.S. Department of Commerce and Wells Fargo Economics

Figure 6



Source: U.S. Department of Commerce and Wells Fargo Economics

The U.S. economy presently has a total trade deficit of $69.4 billion (Figure 6). That reflects a goods deficit of $92.5 billion and a services surplus of $23.1 billion. A similar period of dollar strength can be instructive here. From its 2014 low to its 2015 high, the dollar index rose more than 26%. Using those points, travel imports grew $1.1 billion; travel exports were little changed over the same period.

What would a $1.1 billion dollar swing mean in the context of the broader trade deficit? The net change in the trade deficit over the past three years has been a widening of just $3.4 billion. On that basis, it looks like travel services could be a big deal. But trade data are notoriously volatile month to month. Taking the absolute value of monthly changes in the trade balance, monthly swings averaged $5.0 billion over the past three years. On that basis, a $1.1 billion change in travel services imports appears less consequential.

A final and, in our view, more balanced way to think about it: a swing in the trade of travel services of $1.1 billion would represent a roughly 5% share of the overall trade surplus in services, or a 1.5% share of the total trade balance. That is roughly equal to the 1.7% average annual change in the trade deficit over the past three years. In short, growth in foreign travel may not be enough to wildly move the needle in any given month, but over time, it has scope to be a more consequential factor for net exports than presently appreciated.

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Patrick Barley	Economic Analyst	704-410-1232	Patrick.Barley@wellsfargo.com
Jeremiah Kohl	Economic Analyst	212-214-1164	Jeremiah.J.Kohl@wellsfargo.com
Aubrey George	Economic Analyst	704-410-2911	Aubrey.B.George@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

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